Recent LSTA Publications Explained: MCAPs, Cashless Rolls and Fronting Letters

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Introduction

On August 8, 2014, The Loan Syndications and Trading Association ("**LSTA**") published in final form its latest iteration of the Model Credit Agreement Provisions (the "**2014 MCAPs**"), almost exactly two years after the prior version, published on August 1, 2012 (the "**2012 MCAPs**"). In addition to making certain refinements to the 2012 MCAPs, the 2014 MCAPs address four key topics: the treatment of disqualified institutions, affiliate and borrower buybacks, amend-and-extend transactions and cashless rolls. In a related project, on July 1, 2014, the LSTA published its new form of fronting letter (the "**Fronting Letter**"). As with the 2012 MCAPs, the 2014 MCAPs and form of fronting letter were developed following numerous conference calls with the LSTA's primary market committee, broad consultation with the LSTA membership, multiple comment periods and comprehensive surveys of loan market precedents and practitioners over an almost 12-month period. In a departure from prior practice, the LSTA also specifically invited borrower and sponsor-side counsel participation in the process, though the actual take-up was limited. The end result of this process is a set of provisions that seeks either to reflect market consensus or provide a template around which such consensus could coalesce.

Disqualified Institutions

One of the more controversial topics in credit agreement negotiations over the past few years has been the treatment of "disqualified institutions" (also referred to as "disqualified lenders" or "ineligible institutions"). These are entities that borrowers and/or their related sponsors do not want included in their lending syndicate either because that entity is, or is affiliated with, a competitor that by becoming a lender would gain access to confidential and other sensitive information of the borrower, or because the borrower and/or sponsor otherwise desires to "blacklist" that entity (e.g., a distressed investor with which the borrower and/or sponsor has had negative experiences in the past). The borrowers' position on this issue is legitimate, as illustrated for example in the LightSquared bankruptcy, where both the debtor and other creditors claimed that an industry competitor had joined the bank group to use that position to its own strategic advantage. Investors, in contrast, argue that such limitations are inappropriate as borrowers, particularly in the institutional term loan B market, benefit from bond-like covenant flexibility in large part because of the liquidity of the term loan B market and the type of investor that such liquidity attracts. Accordingly, restrictions that interfere with loan market liquidity by reducing the potential pool of investors should be tightly constrained. In addition, standing squarely between borrowers and the investors are the administrative agent banks. Their role, as memorialized in most credit agreements, has traditionally been limited to certain express obligations, which are generally ministerial and administrative in nature. Administrative agent banks do not generally have the infrastructure to support (and do not believe that they are compensated for) ongoing monitoring of the composition of the bank group and policing of disqualified institution provisions.

In addition to the investors' interest in liquidity, there was some concern among market participants that certain credit agreements addressed the issue in ways that could prove problematic, particularly for the secondary market. For example, borrowers and sponsors had increasingly advocated that assignments (and participations) to disqualified institutions be deemed "void." In the actively traded secondary loan market, an assignment to a disqualified institution may be followed by several downstream assignments. Requiring the unwinding of those assignments, or otherwise untangling of a void assignment from a string

of transactions, had the potential to create significant confusion and uncertainty in the market and may be unworkable. Other credit agreements included “pop up” or optional provisions in the form assignment and assumption agreements, under which an assignee would need to indicate whether or not it was a disqualified institution each time an assignment was entered into. This too created concern that settlement times would be further delayed, especially in deals where it was not absolutely clear whether an assignee qualified as a disqualified institution (e.g., if disqualified institution included “all affiliates” of identified entities).

The LSTA’s task was therefore to balance the interests of the various constituencies and address the potential threats to the liquidity and stability of the secondary market posed by some approaches that had been taken to deal with the disqualified institutions issue.

What Is a Disqualified Institution?

Under the 2014 MCAPs, a “**Disqualified Institution**” is an entity designated by the borrower in writing either prior to the closing of the credit agreement or, solely with respect to competitors of the borrower, from time to time thereafter. The definition of Disqualified Institutions raised several questions. First, to whom must the list of Disqualified Institutions (the “**DQ List**”) be identified and disclosed? Borrowers and sponsors are often sensitive to disclosing their DQ Lists to the broader syndicate as they consider such information proprietary. On the other hand, existing and potential investors in the loans need to know which institutions are on the DQ List to ensure that they are in compliance with the credit agreement when entering into an assignment. Several solutions to these competing interests have been proposed, ranging from requiring that the DQ List be published on the electronic agency platform available to the syndicate, to prohibiting distribution of the DQ List to lenders at all, and instead giving the borrower the ability to review each assignment prior to effectiveness (even where the borrower is in default or otherwise has no consent right with respect to that assignment). Since each approach has merit and each administrative agent bank has developed its own preferred procedure, the 2014 MCAPs leave the exact mechanism to be negotiated between the transacting parties. The key innovation of the 2014 MCAPs is that the negotiated mechanism is now contemplated to be specifically addressed in the credit agreement, and provisions have been added to facilitate the disclosure of the DQ List to lenders, including through the electronic agency platform.

Another area of debate has been the scope of entities that could be added to the group of Disqualified Institutions after the closing date. There are a number of variations in the market ranging from credit agreements that do not allow the DQ List to be updated at all to agreements that include as Disqualified Institutions all affiliates of competitors and entities identified on the DQ List whether or not the affiliate is itself identified. The 2014 MCAPs adopted a middle ground by contemplating updating the DQ List for “Competitors” (which transacting the parties are invited to define on a transaction-specific basis). Transacting parties are, however, always free to choose a more expansive definition of Disqualified Institutions, for example, including affiliates clearly identifiable as affiliates based solely on the similarity of their names whether or not added to the DQ List. However, in doing so, transacting parties will need to carefully assess the impact on other provisions of the 2014 MCAPs and whether such a standard is sufficiently well defined to avoid confusion and delay in the secondary market.

Consequences of Being a Disqualified Institution

The 2014 MCAPs provide that “[n]o assignment or participation shall be made to any Entity that was a Disqualified Institution as of the date (the ‘**Trade Date**’) on which the assigning lender entered into a binding agreement to sell and assign all or a portion of its right and obligations under this Agreement.” Accordingly, if an assignor and an assignee enter into an agreement to purchase and sell loans and the proposed assignee subsequently becomes a Disqualified Institution, the assignor may proceed with the assignment without violating the credit agreement prohibition. In other words, the designation of an assignee as a Disqualified Institution after the applicable Trade Date will not be given retroactive effect.

The 2014 MCAPs further provide that an assignment in violation of the foregoing prohibition does ***not*** render the assignment void. Rather, the 2014 MCAPs set forth in detail the consequences of an assignment in violation of this prohibition. The same consequences also apply to the extent a member of the lending syndicate becomes a Disqualified Institution after the Trade Date. Specifically, the borrower may (i) terminate the Disqualified Institution's revolving commitments; (ii) repurchase the Disqualified Institution's loans at the lowest of par, the price paid by the Disqualified Institution for such assignment [or market price]; and/or (iii) force the Disqualified Institution to assign its loans at such lowest price to a third party. The 2014 MCAPs bracket "market price" in recognition of the difficulty that may exist in establishing a market price at any given time for a particular loan; transacting parties may or may not wish to address this issue in their credit agreement.

In addition, a Disqualified Institution (i) will not be permitted to receive lender-only information, (ii) will not be permitted to attend lender-only meetings and (iii) will effectively have its vote on amendments, waivers or modifications of, or other actions taken under, the credit facility, excluded both prior to and following a bankruptcy proceeding of the borrower. While these consequences generally mirror those applicable to Affiliated Lenders (as described below), note that clause (iii) is more punitive in the context of Disqualified Institutions in that it does not contain an exception for votes where the Disqualified Institution is disproportionately affected.

Waiver of Agent Responsibility and Other Matters

Importantly, the 2014 MCAPs make it clear that the administrative agent bank "shall not be responsible or have any liability for, or have any duty to ascertain, inquire into, monitor or enforce compliance with the provisions [of the MCAPs] relating to Disqualified Institutions." The administrative agent bank is authorized (but not obligated) to post the DQ List to the electronic agency platform and the DQ List is expressly deemed to be suitable for posting on the public side of the platform. As noted above, this provision provides a mechanism for distributing the DQ List to the entire lender group.

Finally, the form of Assignment and Assumption does not require the assignee to "check the box" to confirm that it is not a Disqualified Institution. However, with a slight modification to the standard form of Assignment and Assumption, and the inclusion of a footnote, the LSTA has clarified that, by making the standard representation that the assignee "meets all the requirements to be an assignee," the assignee is effectively representing that it is not a Disqualified Institution on the Trade Date.

Affiliate and Borrower Buybacks

During the period following the 2008 financial crisis, when many loans traded significantly below par, borrower and affiliate buybacks were viewed as an attractive way for borrowers to de-lever. However, credit facilities in effect at that time did not contemplate, and standard sharing and voting provisions arguably prohibited, such non-pro rata buybacks. Since the crisis, there has developed and been included in new and amended credit facilities a reasonably well settled set of provisions that accommodates affiliate and borrower buybacks. The 2014 MCAPs seek to memorialize that market practice.

What Is an "Affiliated Lender"

An "**Affiliated Lender**" is an affiliate of the borrower and, where applicable, the sponsor, other than the borrower and its subsidiaries. There are two categories of Affiliated Lender. "**Debt Fund Affiliates**" are "bona fide debt funds or investment vehicles that are primarily engaged in making, purchasing, holding or otherwise investing in commercial loans, bonds and similar extensions of credit in the ordinary course of business" as to which neither an affiliate of the borrower nor the sponsor "has the power, directly or indirectly, to direct or cause the direction of such Affiliated Lender's investment decisions." Debt Fund Affiliates are thought to be independent of their sponsor, and accordingly the restrictions that apply to them are less stringent than those which apply to other types of Affiliated Lenders (i.e. that are not

independent). Any Affiliated Lender that is not a Debt Fund Affiliate is referred to as a "**Non-Debt Fund Affiliate**."

What Rules Apply to Affiliated Lender Buybacks?

A Non-Debt Fund Affiliate is permitted to purchase term loans (but not revolving loans) pursuant to open-market purchases subject only to (i) identifying itself as a Non-Debt Fund Affiliate and (ii) limiting the aggregate principal amount of term loans held by such Non-Debt Fund Affiliate to a specified percentage to be determined by the contracting parties (typically around 25%, and small enough to avoid constituting a blocking position for any class of debt in a bankruptcy proceeding of the borrower). Note that Non-Debt Fund Affiliates are not required by the 2014 MCAPs to make a "no MNPI" representation, nor are the parties to an assignment to a Non-Debt Fund Affiliate required to provide a "big boy" disclaimer. Once the Non-Debt Fund Affiliate is identified as such to its counterparty, the 2014 MCAPs leave it to the parties to determine how to allocate the related risk, including relying on the LSTA forms of secondary trade documentation to address this issue.

A Non-Debt Fund Affiliate that becomes a lender (i) will not be permitted to receive lender-only information; (ii) will not be permitted to attend lender-only meetings; (iii) will effectively have its vote excluded on amendments, waivers or modifications of, or other actions taken under, the credit facility, except for matters requiring a 100% or all affected-lender vote that adversely affects the Non-Debt Fund Affiliate more adversely than other term lenders; and (iv) will effectively have its vote excluded with respect to a plan of reorganization of the borrower, except to the extent that the plan adversely affects such Non-Debt Fund Affiliate more than other term lenders.

A Debt Fund Affiliate is also permitted to acquire term loans but is exempt from the foregoing restrictions. The only limitation applicable to Debt Fund Affiliates is that its vote on amendments, waivers or modifications of, or other actions taken under, the credit facility, will be excluded to the extent in excess of 49.9% of the amount of loans and commitments required to be held by Lenders in order for them to constitute "Required Lenders." In other words, for any required lender vote, a majority of the consenting Lenders must be entities that are not Debt Fund Affiliates.

What Rules Apply to Borrower Buybacks?

The borrower (and its subsidiaries) are permitted to purchase term loans (but not revolving loans) pursuant to reverse Dutch auction procedures open to all lenders, so long as there is no default or event of default and subject to the borrower representing that it is not in possession of any Excluded Information that has not been disclosed to the term lenders generally (other than term lenders that do not wish to receive such information). "**Excluded Information**" is defined as nonpublic information that could be material to the transacting parties' decision to buy or sell the loans. Upon consummation of the buyback, the loan is immediately and automatically canceled. The 2014 MCAPs have also proposed specified buyback mechanics in a new Exhibit L to afford agents a set of procedures to consider when negotiating definitive documents.

It is worth noting that the "no default" condition, and the right to an equal opportunity to participate in the buyback program and access information, are driven by a key difference between borrower buybacks and affiliate buybacks. A borrower buyback involves using cash of the credit group to make a non-pro rata payment to a group of lenders that have a legitimate expectation to a pro rata claim to that cash, particularly in a default scenario. The same considerations do not arise for affiliate buybacks, where the consideration for such buybacks is cash outside, or that has been permitted to leave, the credit group.

Amend-and-Extend Transactions

Like borrower and affiliate buybacks, amend-and-extend transactions increased in popularity in the immediate aftermath of the financial crisis. Borrowers were looking for ways to adjust their debt maturity

profile and found themselves unable to fully refinance at an attractive rate. Instead, they offered each lender in the existing syndicate the opportunity to extend the maturity or commitment termination in exchange for a fee, better pricing – at least during the extended period – or both. Credit facilities traditionally did not expressly contemplate these transactions, so new and amended credit facilities began to incorporate those mechanics. Although there has been little need to engage these transactions in recent years (as it has been relatively easy to refinance existing facilities in most cases), the 2014 MCAPs incorporate these provisions in recognition of their general market acceptance and possible usefulness in a different pricing environment. The key principles underlying the amend-and-extend provisions are that all lenders of a particular class should be given an equal opportunity to participate on equal terms and that the terms of the extended loans and commitments should not be more favorable than the existing, non-extending loans and commitments. Accordingly, extended term loans are subject to customary maturity and weighted average life limitations, rank *pari passu* with the existing term loans and must receive no better than pro rata treatment in connection with prepayments.

Other 2014 MCAPs Changes

There are a small number of other changes set forth in the 2014 MCAPs that reflect changes in market practice since the 2012 MCAPs. First, in the 2012 MCAPs, fronting exposure (of swingline lenders and letter of credit issuers) was only reallocated from defaulting lenders to non-defaulting lenders if no default existed and all representations were true at the time of the reallocation. Following a review of market precedents and consultation with LSTA members, the 2014 MCAPs were revised to effect such reallocation subject only to the exposure of any non-defaulting lender not exceeding its commitments. Second, the prohibition on assignments to natural persons was expanded to include “holding company, investment vehicle or trusts for, or owned and operated for the primary benefit of, a natural person”. Finally the “yank-a-bank” provision was revised to require majority approval of an affected class of loans before a member of that class could be forcibly replaced with another institution, in recognition of the multiple tranches that often exists in modern credit agreements.

Cashless Rolls

Over the past few years, many borrowers have taken advantage of the historically low interest rate environment to “reprice” their existing credit facilities. Since a conventional amendment to reduce the rate applicable to loans requires the consent of 100% of affected lenders, such repricing transactions were typically structured as “new” facilities and took a number of forms, including amend-and-extends,” incremental facilities (the proceeds of which were used to concurrently prepay existing facilities) and refinancing amendments. For a number of reasons, primarily administrative ease and compliance with fund investment provisions, existing lenders subject to such repricing often requested a “cashless roll” option, i.e., an ability to convert their loans under the existing credit facility into loans under the new, refinancing facility on a cashless basis, without the movement of cash in connection with the repayment and re-borrowing of the facilities.

To accommodate such lender requests, a number of “cashless roll” templates developed, reflecting two general mechanics: (i) an exchange of loans under an existing facility for new loans under the repriced facility and (ii) a continuation of the existing loans as repriced loans. In an attempt to bring order to the market and consistent with the overwhelming majority of such repricing transactions, on August 8, 2014, the LSTA published a Form of Cashless Roll Letter Agreement (the “**Letter Agreement**”), which adopts the “exchange” model, pursuant to which the applicable agent bank facilitates an exchange of existing loans for new, repriced loans on a cashless basis. From the perspective of administrative agent banks, the cashless roll is an accommodation offered to the borrower to assist in the successful completion of a repricing, but should not otherwise interfere with the syndication of the repriced loans. Furthermore, administrative agent banks are not in a position to verify that the cashless roll mechanism complies with investment restrictions applicable to rolling lenders. Accordingly, the critical elements of the Letter

Agreement from the perspective of the administrative agent banks are that it provides that the exchange offer is made by the borrower (not the administrative agent bank) to the existing lenders, the administrative agent bank retains the right to allocate the new loans to existing lenders in its discretion and the borrower and lenders agree to a limitation on the liability of the administrative agent bank for its role in effecting the cashless roll exchange.

To complement this project, language was added to the 2014 MCAPs to make it clear that cashless rolls are permitted in the context of a refinancing or other modification. The language is deliberately agnostic as to the form of cashless roll, including whether or not the Letter Agreement is used.

Fronting Letter

If a term loan financing involves multiple arrangers, the "fronting" arranger (typically the "lead left" arranger) may agree, as an accommodation to the other arrangers, to fund the entire amount of the term loan facility to the borrower on the closing date. In such cases, the fronting arranger and the other arrangers will typically enter into a fronting letter, setting out the terms on which the other arrangers agree to purchase from the fronting arranger their ratable share of any portion of the funded amount that the fronting arranger has not been able to allocate in the primary syndication. In response to member requests, the LSTA decided to update its form of fronting letter (previously published in 2005) to reflect current market practice and address concerns that certain members had expressed with respect to the existing form. The revised form of Fronting Letter was published on July 1, 2014.

The primary revision to the Fronting Letter is to permit the fronting arranger to specify a date that falls within an agreed range of dates following the closing date as the "trade date" for any such purchase by the other arrangers. If the fronting arranger does not specify a trade date, then the trade date automatically defaults to the last day of the specified purchase period. Also, if an event of default under the credit agreement occurs prior to the end of such purchase period, then the fronting arranger may specify as the trade date any date after such event of default and prior to the end of the purchase period. The Fronting Letter requires the other arrangers to settle each purchase as soon as is practicable after the trade date (the "**Effective Date**"). The Fronting Letter further clarifies that interest and regularly accruing fees through the Effective Date are for the account of the fronting arranger.

The Fronting Letter was also revised to permit the other arrangers to request from the fronting arranger information relating to the progress of the syndication and the settlement of allocations from the fronting arranger and to include agreed-upon governing law and confidentiality provisions. The borrower is neither a party to, nor a beneficiary of, the Fronting Letter.

Conclusion

The 2012 MCAPs were broadly accepted by borrowers and lenders alike, with some to-be-expected variations and areas of negotiation. In some respects, the 2014 MCAPs are more ambitious, at least as they relate to Disqualified Institutions, as they attempt to offer middle-of-the-road solutions to disputed issues that have dogged the market in recent years. Whether these provisions are ultimately adopted as broadly as the 2012 MCAPs, or serve as the catalyst for market consensus around issues that are important to the secondary market, the 2014 MCAPs represent a significant step forward on key provisions. Together with the new form of Fronting Letter and cashless roll letter agreement, the 2014 MCAPs cap off a busy first half of the year for the LSTA's primary market committee.

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